

## Client Alert.

---

April 20, 2011

# IRS Issues Follow-Up Guidance on FATCA Reporting and Withholding Requirements

By Thomas A. Humphreys, R Emmelt A. Reigersman and Jared B. Goldberger

On April 8, 2011, the Internal Revenue Service (“IRS”) and Treasury Department (“Treasury”) issued Notice 2011-34 (the “Notice”) setting forth additional guidance with respect to the reporting and withholding requirements under the Foreign Account Tax Compliance Act (“FATCA”).<sup>1</sup> FATCA introduced a new 30% withholding tax on any “withholdable payment” made to either a foreign financial institution (“FFI”) or a non-financial foreign entity (“NFFE”) unless the FFI meets certain reporting obligations or the NFFE discloses certain information regarding substantial U.S. owners. A “withholdable payment” generally includes any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income from sources within the U.S. It also includes gross proceeds from the sale of property that is of a type that can produce U.S.-source dividends or interest, such as stock or debt issued by domestic corporations. The new 30% withholding tax on any “withholdable payment” made to an FFI (whether or not beneficially owned by such institution) applies unless the FFI agrees, pursuant to an agreement entered into with Treasury (“FFI Agreement”), to provide information with respect to each “financial account” held by “specified U.S. persons” and “U.S.-owned foreign entities.”

The new reporting and withholding provisions apply to payments made after December 31, 2012 and obligations outstanding on March 18, 2012 are grandfathered.

The IRS and Treasury published preliminary guidance in Notice 2010-60, issued on August 27, 2010, regarding (1) the grandfather provision, (2) the definition of an FFI, (3) the scope of required information collection and identification of persons by FFIs, and (4) the manner and type of information that FFIs must provide to the IRS with respect to U.S. accounts.<sup>2</sup>

The Notice addresses seven areas of concern with respect to FFIs, which we discuss below, including (1) the procedures to be followed by FFIs in identifying U.S. accounts among their preexisting individual accounts, (2) the definition of the term “passthru payment,” (3) certain categories of FFIs that will be deemed compliant, (4) reporting obligations on U.S. accounts, (5) requirements for FFIs that are Qualified Intermediaries (“QIs”), (6) the requirements for expanded affiliated groups of FFIs, and (7) the effective date of FFI Agreements. The Notice further indicates that the IRS and Treasury intend to issue regulations incorporating the guidance described in the Notice along with other relevant matters. The IRS and Treasury additionally intend to publish draft FFI Agreements and draft information reporting and certification forms.

---

<sup>1</sup> FATCA was included in the Hiring Incentives to Restore Employment Act of 2010. See our prior client alert discussing the FATCA provisions at <http://www.mofo.com/files/Uploads/Images/100322FATCA.pdf>.

<sup>2</sup> See our prior client alert discussing Notice 2010-60 at <http://www.mofo.com/files/Uploads/Images/100910FACTA.pdf>.

# Client Alert.

## 1. PREEXISTING INDIVIDUAL ACCOUNTS

In the case of “preexisting individual accounts” (defined as any financial account held by an individual as of the date that an FFI Agreement becomes effective), the FFI is required to determine whether such accounts are to be treated as (1) U.S. accounts, (2) accounts of recalcitrant account holders (“recalcitrant accounts”), or (3) accounts that are other than U.S. accounts (“non-U.S. accounts”). The Notice provides procedures to assist the FFI in this determination. Once the process is complete, the FFI’s chief compliance officer must certify such completion to the IRS (no deadline has been set as of yet but the IRS has indicated one is forthcoming). The steps to be taken in this process are as follows:

Step 1: Account holders documented as U.S. persons for other U.S. tax purposes will be treated as holding U.S. accounts. However, unless the FFI elects otherwise, an account is a non-U.S. account if (i) the account is a depository account; (ii) each holder is a natural person; and (iii) the balance at the end of the year preceding the FFI Agreement’s effective date does not exceed \$50,000 (or the equivalent foreign currency).

Step 2: Accounts not identified as U.S. accounts pursuant to Step 1 may be treated as a non-U.S. account if the balance at the end of the year preceding the FFI Agreement’s effective date does not exceed \$50,000 (or the equivalent foreign currency). The FFI may elect out of applying this step.

Step 3: The Notice provides detailed guidelines with respect to private banking accounts<sup>3</sup> maintained by the FFI that are not categorized as a U.S. or non-U.S. account pursuant to Step 1 or 2. The Notice gives relationship managers at private banks the responsibility of finding indicia of U.S. accounts.

Step 4: If an account has not yet been identified as a U.S. account, non-U.S. account, or private banking account pursuant to Steps 1 through 3, the FFI must determine whether an account has specified U.S. indicia from electronically maintained information. For those accounts that contain U.S. indicia, the FFI is required within one year of the effective date of its FFI Agreement to request certain documentation to establish whether such account is a U.S. account.

Step 5: The FFI must review high value accounts (accounts with a balance of \$500,000 or more at the end of the year preceding the effective date of the FFI Agreement) with respect to accounts that have not been categorized under Steps 1 through 4. To the extent such accounts contain U.S. indicia, the FFI must obtain certain documentation within two years following the effective date of its FFI Agreement. Account holders that do not provide appropriate documentation will be classified as “recalcitrant account holders.”

Step 6: For those accounts that did not previously meet the requirements to be treated as a high value account but would have been treated as high value accounts based on the account balance on the last day of the preceding year, the FFI is required to annually apply the high value account procedure commencing the third year following the effective date of its FFI Agreement. Those accounts identified as high value accounts under this retesting process will be treated as recalcitrant if required documentation is not provided by the end of the year identified.<sup>4</sup>

## 2. PASSTHRU PAYMENTS

The Notice provides guidance with regards to the obligation of an FFI to withhold on a passthru payment. An FFI is required to deduct and withhold 30% of any passthru payment made to a recalcitrant account holder or non-participating

<sup>3</sup> These are generally accounts maintained or serviced by an FFI’s private banking department.

<sup>4</sup> Completion of annual retesting (i.e., Step 6) is not required to be certified to the IRS by the chief compliance officer.

# Client Alert.

FFI. A passthru payment includes (i) any withholdable payment, and (ii) other payments to the extent attributable to a withholdable payment. With respect to this second category of passthru payments, the Notice indicates that the IRS and Treasury intend to issue regulations that payments “attributable to a withholdable payment” are amounts of non-withholdable payments multiplied by a fraction (the “passthru payment percentage”).<sup>5</sup>

An FFI’s passthru payment percentage is determined by dividing the sum of the FFI’s U.S. assets<sup>6</sup> held on each of the last four quarterly testing dates,<sup>7</sup> by the sum of the FFI’s total assets held on those dates.<sup>8</sup> Each FFI will be required to make available its quarterly passthru payment percentage information within three months of the relative quarterly testing date. Grandfathered obligations will not be factored into an entity’s passthru payment percentage.

### 3. DEEMED-COMPLIANT STATUS FOR CERTAIN FFIS

The Notice provides that certain categories of FFIs will be deemed compliant with the requirements of FATCA. An FFI that is deemed compliant must (i) apply for deemed-compliant status with the IRS, (ii) obtain an FFI identification number from the IRS, and (iii) certify every three years that it meets the requirements for deemed-compliant treatment.

The IRS and Treasury intend to issue regulations that FFIs in an expanded affiliated group<sup>9</sup> will be treated as a deemed compliant FFI if: (i) each FFI is, under the laws of its country of organization, licensed and regulated as a bank or similar organization authorized to accept deposits in the ordinary course of its business; (ii) all of the FFIs are organized in the same country; (iii) no FFI maintains operations outside the country of organization; (iv) no FFI solicits account holders outside its country of organization; and (v) each FFI implements policies and procedures to ensure that it does not open or maintain accounts for non-residents, non-participating FFIs, or NFFEs (other than excepted NFFEs that are organized and operating in the jurisdiction where all members of the expanded affiliated group are organized).

In addition, the IRS and Treasury intend to issue similar regulations in which any FFI that is a member of an expanded affiliated group that includes one participating FFI may be treated as a deemed-compliant FFI,<sup>10</sup> as well as regulations under which certain collective investment vehicles and other investment funds would be treated as deemed-compliant.<sup>11</sup> Treasury and the IRS are still considering under what circumstances certain foreign entities, all the interests in which are

<sup>5</sup> As indicated in the Notice, the purpose of the passthru payment rule is to encourage FFIs to enter into FFI Agreements (without this rule, it may be possible for non-participating FFIs to hold indirect U.S. investments through participating FFIs without being subject to a withholding tax while avoiding entering into an FFI Agreement).

<sup>6</sup> A U.S. asset will be defined to include any asset to the extent that it is of a type that could give rise to a passthru payment and any debt or equity interest in a U.S. corporation but does not include any grandfathered obligations. A debt or equity interest in an NFFE will be treated as a non-U.S. asset.

<sup>7</sup> The quarterly testing date for an FFI will generally be the last business day of the quarter (or the last redemption date of the quarter if the FFI conducts redemptions at least quarterly).

<sup>8</sup> Custodial payments are determined by reference to the passthru payment percentage of the issuer of the instrument and not of the FFI making the payment.

<sup>9</sup> Defined as “an ‘affiliated group’ as defined by section 1504(a), determined by substituting ‘more than 50 percent’ for ‘at least 80 percent’ in each place it appears in section 1504(a) and without regard to paragraphs (2) and (3) of section 1504(b).” A partnership or any other entity (other than a corporation) is treated as a member of an expanded affiliated group if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this rule).

<sup>10</sup> The FFI may not maintain operations or solicit account holders outside its country of organization and must implement the pre-existing account and customer identification procedures of participating FFIs.

<sup>11</sup> Provided that (i) all holders of direct interests in the fund are participating FFIs or deemed-compliant FFIs holding on behalf of other investors, (ii) the fund prohibits the subscription for or acquisition of interests in the fund by any other person, and (iii) the fund certifies that any passthru payment percentages it calculates and publishes will be done in accordance to the procedures described above.

## Client Alert.

---

regularly traded on an established securities market (e.g., exchange-traded funds), as well as whether certain foreign retirement plans could be deemed compliant.

### 4. REPORTING ON U.S. ACCOUNTS

Notice 2010-60 provided preliminary guidance regarding the manner and type of information FFIs would be required to report with respect to their U.S. accounts. The Notice indicates that the IRS and Treasury intend to issue regulations limiting FFIs' account balance reporting obligations to year-end account balances or values.

With regards to FATCA's requirement of the reporting of gross receipts and gross withdrawals or payments made to and from U.S. accounts, the IRS and Treasury intend to issue regulations providing that an FFI must annually report the following information with respect to a U.S. account: (i) the gross amount of dividends paid or credited to such account, (ii) the gross amount of interest paid or credited to such account, (iii) other income paid or credited to such account, and (iv) gross proceeds from the sale or redemption of property paid or credited to such account with respect to which the FFI acted as custodian, broker, nominee, or otherwise as an agreement for the account holder. In the case of a U.S. account that is an equity or debt interest in the FFI, the FFI will be required to report with respect to such interest, the gross amount of: (i) all distributions, interest, and similar amounts credited during the year, and (ii) each redemption payment made during the year. The IRS and Treasury intend to issue additional guidance with respect to reporting tax basis information for FFIs that are not U.S. payors and branch and affiliate reporting for FFIs that do not elect branch-by-branch reporting.

### 5. REQUIREMENTS FOR QIS

Since QIs that are FFIs will be subject to the FATCA requirements in addition to the existing reporting and other requirements imposed on QIs, the IRS and Treasury intend to issue guidance requiring all FFIs currently acting as QIs to consent to include in their QI agreements the requirement to become participating FFIs (unless it is deemed-compliant).

### 6. WITHHOLDING, REPORTING, AND OTHER REQUIREMENTS REGARDING EXPANDED AFFILIATED GROUPS OF FFIS

FATCA provides that the withholding, reporting, and other requirements imposed on an FFI shall apply with respect to U.S. accounts maintained by the FFI, including U.S. accounts maintained by each other FFI that is a member of the same expanded affiliated group that includes the FFI. The IRS and Treasury intend to issue regulations requiring each FFI included in the affiliated group to be either a participating or deemed-compliant FFI. This would be achieved through a coordinated application, rather than individual, process. The FFI affiliated group will designate a "lead FFI" to execute the FFI agreement for all participating FFIs and certifications for deemed-compliant FFIs.

### 7. EFFECTIVE DATE OF FFI AGREEMENTS

The Notice provides that FFI Agreements will become effective on the later of (i) the date they are executed, or (ii) January 1, 2013.

# Client Alert.

---

**Contact:**

**Thomas A. Humphreys**

(212) 468-8006

[thumphreys@mofo.com](mailto:thumphreys@mofo.com)

**Remmelt A. Reigersman**

(212) 336-4259

[rreigersman@mofo.com](mailto:rreigersman@mofo.com)

**Jared B. Goldberger**

(212) 336-4441

[jgoldberger@mofo.com](mailto:jgoldberger@mofo.com)

**About Morrison & Foerster:**

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer's* A-List for seven straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at [www.mofo.com](http://www.mofo.com).

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.*